SOOS CREEK WATER & SEWER DISTRICT

14616 S.E. 192nd St. • P.O. Box 58039 • Renton, WA 98058-1039 • Phone (253) 630-9900 • Fax (253) 630-5289

April 13, 2015

The Honorable Michael Crapo, Chairman
Savings and Investment Tax Reform Working Group
United States Senate Finance Committee
United States Senate
Washington, D.C. 20510

The Honorable Sherrod Brown, Chairman
Savings and Investment Tax Reform Working Group
United States Senate Finance Committee
United States Senate
Washington, D.C. 20510

Re: Comments regarding HRA/VEBA for Savings and Investment Tax Reform Working Group

Dear Chairman Crapo and Chairman Brown:

On behalf of Soos Creek Water and Sewer District (SCWSD), we thank you for the opportunity to provide comments to the Savings and Investment Tax Reform Working Group on reforming the tax code. We are writing to urge you to include the provision to clarify the rules for certain governmental plans that was approved by the Senate Finance Committee on February 11, 2015 in any recommendations made by the group.

SCWSD is one of the largest utilities in the State of Washington. We currently serve more than 96,500 people within 35 square miles in portions of the Cities of Auburn, Black Diamond, Covington, Kent, Maple Valley, Renton, and Unincorporated King County.

As discussed in more detail, below, this proposal has bipartisan and bicameral support. Further, it is consistent with several bipartisan principles for tax reform. It restores fairness to the tax code by treating participants in HRA VEBA plans provided by fire districts, school districts, public utility districts, counties, cities, ports, and other political subdivisions in the same manner as participants in similarly situated HRA VEBA plans established in connection with public retirement systems. It promotes savings and investment for future medical costs. And, it provides certainty and consistency for almost 150,000 public servants who were inadvertently left out of legislation passed in 2008 intended to treat all such plans in the same manner.

Background:

A health reimbursement arrangement (HRA) is a type of health plan that reimburses qualified health care costs and insurance premiums for employees, their spouses and qualified dependents. In an "HRA VEBA," funds are deposited by the employer into participant accounts held by a nonprofit, tax-exempt voluntary employees' beneficiary association (VEBA) trust authorized under section 501(c)(9) of the Internal Revenue Code.

HRA plans provided through VEBA trusts are widely-used, valuable tools for public sector employers seeking to recruit and retain employees by offering them health care benefits competitive with the private sector.

Request:

To revise Internal Revenue Code (IRC) section 105 to include plans established by or for a political subdivision, and clarify those payments to the participant, spouse, dependents and children under age 27 are non-taxable, while reimbursements to others are taxable.

Problem:

IRC section 105(b) provides, generally, that gross income does not include amounts received under accident and health plans attributable to contributions by the employer if such amounts are paid to reimburse the taxpayer for expenses incurred by the taxpayer for the medical care of the taxpayer, his spouse, his dependents, and any child under the age of 27 by the end of the taxable year. HRA VEBAs are a vehicle used to provide such benefits.

For decades, these plans also allowed reimbursements to non-spousal/non-dependent beneficiaries, and these payments were fully taxable. However, after years of administering HRA VEBAs in this manner, Revenue Ruling 2006-36 suddenly changed all this. It ruled that amounts paid to an employee under a reimbursement plan - including amounts paid on behalf of the employee, spouse or dependent - are not excludible from gross income if the plan provides that amounts may be paid to a non-spousal/non-dependent beneficiary. As a result of this ruling, plans prohibited payments to non-spousal/non-dependent beneficiaries, meaning the hard-earned savings of employees without a surviving spouse or dependent beneficiary are forfeited upon death. Instead, the funds from that account are redistributed among the plan's surviving participants.

Participants in HRA VEBA plans could not have anticipated the revenue ruling or its effect. Many employees had, over years of participation in their HRA VEBA plan, chosen to defer earnings as a way to save for current and future health care needs, operating under the reasonable assumption that they would be able to pass on their benefits after death. Once the ruling was issued, they had no recourse to ensure their benefits would not be lost upon death.

To remedy the situation, Congress created IRC section 105(j). It was first included in the Pension Protection Technical Corrections Act of 2008 (H.R.6382), which was then rolled into the Worker, Retiree and Employer Recovery Act of 2008 (H.R.7327) and passed by Unanimous Consent in both the House and Senate (PL 110-458).

The legislation fixed the problem for most HRA VEBAs, but unintentionally omitted plans established by or for a political subdivision. Thus, participants in plans provided by fire districts, school districts, public utility districts, counties, cities, ports, and other political subdivisions are still prohibited from passing on their savings to a non-spousal/non-dependent beneficiary (even though such payments would be taxable to those recipients). Per the IRS revenue ruling, unless such payments are prohibited, ALL distributions from such plan are taxable to the employee, even those going to the employee, the spouse and any dependents.

This distinct, unfair and arbitrary disadvantage affects over 1,150 employers and over 131,000 employees throughout the northwest and across the country and can only be remedied through legislative measures.

Solution:

This problem could be easily remedied as described in JCX-26-15, "Description of the Chairman's Mark of a Proposal to Clarify Special Rule for Certain Governmental Plans; or, H.R. 869, "To amend the Internal Revenue Code of 1986 to broaden the special rules for certain governmental plans under section 105(j) to include plans established by political subdivisions." Both would amend IRC section 105(j) to include plans established by or for a political subdivision. Payments to the participant, spouse, dependents and children under age 27 would be non-taxable, while reimbursements to others would be taxable.

Current status:

A proposal to clarify a special rule for certain governmental plans was included in the Senate Finance Committee Open Executive Session to Consider Various Original Tax Bills and passed unanimously via voice vote en bloc with other noncontroversial provisions on February 11, 2015.

Representatives Reichert (R -WA) and Blumenauer (D - OR) introduced H.R. 869 on February 11, 2015 to include plans established by political subdivisions.

Proposal History:

Senate:

- S. 2660 introduced by Senators Cantwell (D -WA), Crapo (R - ID), Murray (D - WA), and Risch (R - ID) in the 113th Congress. Senators Klobuchar (D - MN) and Merkley (D - OR) cosponsored the bill.
- S. 1366 introduced by Senators Cantwell (D - WA) and Crapo (R - ID) in the 112th Congress. All of the senators from Washington, Oregon, Idaho and Minnesota cosponsored the bill, together with Senator Tester from Montana. Senate Committee Finance Chairman Baucus strongly supported the legislation.

- Proposal was included in the 2013 Senate Finance Committee Options Paper on Economic Security (3. f., Page 13).

House:

- Included in Chairman Camp's Tax Reform Act of 2014 (HR 1, Page 190, Section 1418 (b)).
- H.R. 4567 introduced by Representatives Reichert (R - WA) and Blumenauer (D - OR) in the 113th Congress. This legislation received strong bipartisan support from across the Northwest and Minnesota.
- H.R. 2698 introduced by Representatives Reichert (R - WA) and Blumenauer (D - OR) in the 112th Congress. The entire delegations of Washington, Oregon, Idaho and Montana cosigned the bill, as did many members of the Minnesota delegation.
- Included in the 2013 "Report to the House Committee on Ways and Means on Present Law and Suggestions for Reform Submitted to the Tax Reform Working Groups."

Other Support:

This proposal is strongly supported by a broad coalition of counties, cities, ports, fire districts, public utility districts, school districts, other political subdivisions and their employees. Discussions with Congressional staff, including Senate Finance Committee and Ways and Means Committee staff, also indicate support for this proposal.

Again, thank you for the opportunity to provide comments and for considering our issue in the working group. Please contact Shirley Speidell at Shirley@smitsspeidell.com or 703-690-1017 if you have any questions or would like to discuss the issue.

Sincerely,

Steve Pfaff

Steve Pfaff
Commissioner